

## Message Text

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ACTION NEA-12

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

NSAE-00 NSC-07 PA-04 RSC-01 PRS-01 SPC-03 SS-20

USIA-15 AID-20 COME-00 EB-11 FRB-02 TRSE-00 XMB-07

OPIC-12 CIEP-02 LAB-06 SIL-01 OMB-01 IGA-02 STR-08

AGR-20 FEA-02 INT-08 DRC-01 /190 W

----- 112853

R 270800Z MAR 74

FM AMEMBASSY ISLAMABAD

TO SECSTATE WASHDC 3942

INFO AMCONSUL KARACHI

AMCONSUL LAHORE

LIMITED OFFICIAL USE SECTION 1 OF 3 ISLAMABAD 02930

KARACHI PASS ALSO TO USAID DIRECTOR

E.O. 11652: N/A

TAGS: IBRD, EAID, EFIN, PK

SUBJ: GOP REACTION TO IBRD STUDY OF PAKISTAN'S LONG-TERM

DEBT RELIEF NEEDS

SUMMARY: GOP SEC-GEN FINANCE AND ECONOMIC COORDINATION  
A.G.M. KAZI HOSTED MEETING AND LUNCHEON ATTENDED BY CON-  
SORTIUM COUNTRY AMBASSADORS AND/OR REPS MARCH 26; GUESTS  
WERE HANDED AIDE MEMOIRE ON PAKISTAN'S DEBT PROBLEM. US  
MISSION REPRESENTED BY ECON/COMM COUS., ACTING USAID  
DEPUTY DIRECTOR, AND USAID CHIEF DIV. ECON ANALYSIS. THIS  
MESSAGE TRANSMITS TEXT OF AIDE MEMOIRE; COMMENT WILL  
FOLLOW. ANNEXES BEING POUCHED. END SUMMARY.

1. TEXT OF AID MEMOIRE FOLLOWS:

"PAKISTAN'S DEBT PROBLEM HAS BEEN UNDER EXAMINA-  
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TION OF THE CONSORTIUM SINCE 1968. THE PROBLEM, HOWEVER,

ACQUIRES A NEW CHARACTER AND SPECIAL URGENCY AFTER THE SEPARATION OF EAST PAKISTAN IN DECEMBER 1971. IN MAY 1972, A SHORT-TERM DEBT RESCEDULING WAS AGREED UPON, FOLLOWED BY A SECOND SHORT-TERM ARRANGEMENT COVERING THE PERIOD UPTO JUNE 1974. THESE AGREEMENTS RESCHEDULED ABOUT 56 PERCENT OF THE DEBT SERVICING FALLING DUE DURING THE PERIOD MAY 1, 1971 TO JUNE 30, 1974. THE RESCHEDULED AMOUNTS WERE TO BE REPAID OVER A PERIOD OF THREE YEARS. THIS SHORT-TERM RESCHEDULING WAS NOT BASED ON A STUDY OF THE DEBT PROFILE OF PAKISTAN; IT WAS THE UNDERSTANDING THAT ANY DIFFICULTIES CREATED BY THIS SHORT-TERM ARRANGEMENT WOULD BE TAKEN CARE OF IN THE LONG-TERM DEBT RELIEF ARRANGEMENT FOR PAKISTAN. THE ISSUE REGARDING THE LIABILITY OF EAST PAKISTAN (NOW BANGLADESH) DEBT WAS ALSO LEFT OPEN EXCEPT TO THE ESTENT OF SPECIFYINL THAT AFTER JUNE 1974, PAKISTAN WOULD NOT BE REQUIRED TO SERVICE ANY OFFICIAL DEBTS INCURRED FOR PROJECTS VISIBLY LOCATED IN BANGLADESH. THE MEMORANDUM OF UNDERSTANDING SIGNED ON JULY 31, 1973, PROVIDED THAT 'DURING THE YEAR OF THIS RELIEF, A STUDY WOULD BE MADE OF PAKISTAN'S DEBT SITUATION, IN RESPONSE TO ITS REQUEST FOR LONG-TERM DEBT RELIEF AND THAT STUDY WOULD TAKE ACCOUNT OF ALL ASPECTS OF PAKISTAN'S DEBT BURDEN.'

"2. THE WORLD BANK STAFF CARRIED OUT A STUDY WHICH WAS DISCUSSED AT A MEETING OF THE HEADS OF DELEGATIONS OF CONSORTIUM MEMBERS AT PARIS ON FEBRUARY 14, 1974. PAKISTAN OFFICIALS HAVE SINCE HAD AN OPPORTUNITY TO FORMALLY DISCUSS THE SUTDY WITH THE WORLD BANK STAFF FROM MARCH 19 TO 21, 1974, AT ISLAMABAD. THE STUDY THROWS LIGHT ON DIFFERENT ASPECTS OF PAKISTAN'S DEBT PROBLEM -- ITS ORIGIN AND EVOLUTION AS WELL AS ITS LATEST POSITION. HOWEVER, IT FOCUSSES ATTENTION ON ONLY ONE ASPECT OF THE PROBLEM: THE NEED FOR SHAVING OFF THE 'HUMP' IN DEBT SERVICING PAYMENTS EXPECTED TO ARISE DURING THE NEXT THREE YEARS AS A RESULT OF THE PREVIOUS SHORT-TERM RESCHEDULING. THE STUDY HAS SUGGESTED A RESCHEDULING OF \$110 MILLION ANNUALLY FOR THE FISCAL YEARS 1974-75, 1975-76 AND 1976-77, FOLLOWED BY A RESCHEDULING OF \$30 MILLION IN 1977-78. THE AMOUNTS SO RESCHEDULED ARE PROPOSED TO BE PAID OVER A PERIOD OF 30 YEARS, INCL-

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UDING 10 YEARS  
OF GRACE, AT 2.5 PERCENT INTEREST.

"3. THESE RECOMMENDATIONS APPEAR TO BE ADEQUATE FOR MEETING THE 'HUMP' PROBLEM WHICH HAS EMERGED FROM THE TERMS OF THE EARLIER SHORT-TERM DEBT RESCEDULING ARRANGEMENTS. HOWEVER, THEY DO NOT DEAL WITH THE BASIC ISSUES OF PAKISTAN'S DEBT PROBLEM, VIZ.,

(A) THE LIABILITY IN RESPECT OF BANGLADESH DEBT,

(B) THE HEAVY BURDEN OF THE REMAINING DEBT, WHICH IS  
BEYOND THE DEBT SERVICING CAPABILITY OF PAKISTAN,  
PARTICULARLY IN VIEW OF ITS RECENT BALANCE OF PAYMENTS  
PROBLEMS.

"4. AS REGARDS THE BANGLADESH DEBTS, THE LATEST INFOR-  
MATION SHOWS THAT CONSORTIUM DEBT PERTAINING TO EAST PAKISTAN  
AMOUNTED TO \$1261 MILLION ON DECEMBER 31, 1971. SINCE THEN  
PAKISTAN HAS BEEN ABSOLVED OF THE RESPONSIBILITY FOR SERVIC-  
ING THE OFFICIAL PROJECT LOANS PERTAINING TO BANGLADESH AND  
SOME OTHER ADJUSTMENTS HAVE BEEN MADE REDUCING THE LIABILITY  
TO \$884 MILLION FROM JULY 1974. (ALL FIGURES HAVE BEEN CON-  
VERTED INTO DOLLARS AT SMITHSONIAN RATES OF EXCHANGE.) DE-  
TAILS ARE GIVEN IN ANNEXURE I. THE IMPLICATIONS OF THE  
SILENCE OF THE BANK STUDY ON THIS ISSUE ARE THAT, EVEN UNDER  
THE LONG-TERM ARRANGEMENT ENVISAGED BY THE STUDY, PAKISTAN  
WILL BE REQUIRED TO CARRY THIS LIABILITY IN RESPECT OF THE  
FOLLOWING TYPES OF DEBT INCURED FOR THE BENEFIT OF BANGLADESH:

(A) PRIVATE AND JOINT COMPLETED PROJECT LOANS,

(B) BANK GROUP FINANCED COMPLETED PROJECTS,

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----- 109633

R 270800Z MAR 74

FM AMEMBASSY ISLAMABAD

TO SECSTATE WASHDC 3943

INFO AMCONSUL KARACHI  
AMCONSUL LAHORE

LIMITED OFFICIAL USE SECTION 2 OF 3 ISLAMABAD 2930

KARACHI PASS ALSO TO USAID DIRECTOR

- (C) COMMODITY LOANS,
- (D) RESCHEDULED PROJECT AND COMMODITY LOANS.

"5. PAKISTAN HAS CONSISTENTLY HELD THE VIEW THAT BANGLADESH DEBT IS NOT HER LEGAL OR MORAL LIABILITY. THE CREDITORS HAVE DIFFERED ON THE LEGAL ASPECTS OF THE CASE, BUT THERE HAS BEEN NO DOUBT THAT IN EQUITY AND FAIRNESS PAKISTAN SHOULD NOT BE BURDENED WITH LIABILITIES THAT WERE INCURRED FOR THE BENEFIT OF THE TERRITORY WHICH IS NOW BANGLADESH. AMONG THE NON-CONSORTIUM COUNTRIES, CHINA, USSR, POLAND, CZECHOSLOVAKIA, YUGOSLAVIA AND DENMARK HAVE AGREED TO REMOVE LIABILITY IN RESPECT OF BANGLADESH DEBT. AMONG CONSORTIUM MEMBERS, SWEDEN HAS ALREADY SIGNED AN AGREEMENT IMPLEMENTING THIS PRINCIPLE. IF THERE ARE ANY INSUPERABLE DIFFICULTIES IN THE WAY OF THE REMAINING CONSORTIUM COUNTRIES REMOVING THE LIABILITY FOR THIS PART OF THE DEBT, PAKISTAN IS WILLING TO ACCEPT AN ARRANGEMENT UNDER WHICH SHE WOULD CONTINUE TO LIMITED OFFICIAL USE

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SERVICE SUCH DEBTS, PROVIDED SHE IS ADEQUATELY COMPENSATED FOR THIS THROUGH DEBT RESCHEDULING ARRANGEMENTS.

"6. ROUGH STUDIES MADE AT THIS STAGE SHOW THAT THE PRESENT VALUE(IN 1974--75) OF ALL DEBT PAYMENTS BY PAKISTAN IN RESPECT OF BANGLDESH DEBT AMOUNT TO \$639 MILLION AS DETAILED IN ANNEXURE II. IN FAIRNESS TO PAKISTAN, IF SHE IS REQUIRED TO CARRY THIS HEAVY BURDEN, THE PRESENT VALUE OF THE GRANT ELEMENT IMPLICIT IN DEBT RESCHEDULING ARRANGEMENTS SHOULD BE GREATER THAN THIS LIABILITY. THE RELIEF PROPOSED IN THE BANK STUDY INVOLVES A GRANT ELEMENT OF ONLY ABOUT \$200 MILLION, WHICH IS OBVIOUSLY WHOLLY INADEQUATE.

"7. THE BANK STUDY PROCEEDS ON THE ASSUMPTION THAT THE RAPID INCREASE IN THE EXPORT EARNINGS OF PAKISTAN IN THE RECENT PAST HAS CORRESPONDINGLY INCREASED HER DEBT SERVICING CAPABILITY. SUCH, UNFORTUNATELY, IS NOT THE CASE. PAKISTAN'S BALANCE OF PAYMENTS SHOWED SIGNS OF STRENGTHENING DURING 1972-73. DURING THAT YEAR, PAKISTAN'S EXPORT PERFORMANCE KEPT AHEAD OF THE INCREASE IN THE IMPORT LEVEL, GIVING RISE TO A SURPLUS ON THE BALANCE OF PAYMENTS AND AN INCREASE IN FOREIGN EXCHANGE RESERVES OF THE COUNTRY BY \$148 MILLION. DURING 1973-74, HOWEVER, ALTHOUGH PAKISTAN HAS CONTINUED TO

GET THE ADVANTAGE OF HIGH PRICES FOR HER MAJOR EXPORTS, THIS HAS BEEN MORE THAN OFFSET BY STEEP INCREASES IN THE PRICES OF IMPORTS. THE MAJOR ITEMS ARE WHEAT (WHICH IS NO LONGER AVAILABLE UNDER PL-480 ARRANGEMENTS) EDIBLE OILS, FERTILISERS AND P.O.L. THE PRICE INCREASES ARE MANIFOLD IN EACH OF THESE ITEMS, IN WHICH QUANTITATIVE REDUCTIONS IN IMPORTS ARE VIRTUALLY IMPOSSIBLE IN THE SHORT RUN WITHOUT ENTAILING GRAVE CONSEQUENCES. THUS, WHILE EXPORTS MAY STILL RISE BY ABOUT 35 PERCENT DURING 1973-74, IMPORTS ARE UNAVOIDABLY EXPECTED TO INCREASE BY OVER 60 PERCENT. THIS HAS MAGNIFIED THE ALREADY EXISTING DEFICIT IN THE TRADE BALANCE TO A LEVEL OF ABOUT \$400 MILLION. AVAILABILITY OF FOREIGN ASSISTANCE, INCLUDING SHORT-TERM BORROWING FOR FOOD, AMOUNTING TO \$424 MILLION WOULD HELP MEET THIS GAP. HOWEVER, AS WOULD APPEAR FROM ANNEXURE III, THERE WOULD BE A DEFICIT OF \$168 MILLION IN OUR BALANCE OF PAYMENTS. THIS CLEARLY INDICATES THAT DURING THE CURRENT YEAR WE WILL BE FINANCING THE DEBT SERVICING PAYMENTS LIMITED OFFICIAL USE

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AMOUNTING TO \$197 MILLION, BY SHORT-TERM BORROWINGS AND DRAWING DOWN OF OUR RESERVES.

"8. IT IS OBVIOUS THAT THE ADVERSE MOVEMENT IN THE TERMS OF TRADE AGAINST PAKISTAN HAS GIVEN A SERIOUS SETBACK TO PAKISTAN'S BALANCE OF PAYMENTS POSITION. THIS SETBACK HAS BEEN VERY SUDDEN AND SHARP. THIS HAS BEEN BROUGHT ABOUT BY FACTORS BEYOND PAKISTAN'S CONTROL. IT IS PART OF A PHENOMENON WHICH IS FULLY WITHIN THE KNOWLEDGE OF THE WORLD BANK AND THE CONSORTIUM COUNTRIES. POLICY RESPONSE FROM PAKISTAN IN THE SHORT-RUN CANNOT IMPROVE THE SITUATION TO ANY APPRECIABLE EXTENT. OVER THE NEXT 3 OR 4 YEARS, PAKISTAN IS PLANNING TO CARRY OUT MAJOR IMPORT SUBSTITUTION IN FOOD AND FERTILISERS. EXPANSION OF HYDRO-ELECTRIC GENERATING CAPACITY, SUBSTANTIAL INCREASE IN OIL PRODUCTION AND REFINING AND EXTENSION OF THE GAS DISTRIBUTION NETWORK WOULD REDUCE DEPENDENCE ON OIL IMPORTS. WHILE IMPLEMENTING THIS STRATEGY FOR IMPROVING THE BALANCE OF PAYMENTS POSITION AND OVERCOMING THE EFFECTS OF THE RECENT ENERGY CRISIS, PAKISTAN FINDS THAT ITS DEBT SERVICING CAPACITY IN THE NEXT SEVERAL YEARS HAS BEEN SHARPLY CURTAILED.

"9. PRELIMINARY PROJECTIONS OF VARIOUS ELEMENTS IN THE BALANCE OF PAYMENTS SHOW THAT THE SITUATION IS LIKELY TO BE UNDER INTENSIFIED PRESSURES BEFORE IMPROVEMENTS CAN BE EXPECTED. PAKISTAN'S DEBT SERVICING CAPACITY DURING THIS PERIOD IS, ON ALL INDICATIONS, LIKELY TO BE VERY LOW. HOWEVER, PAKISTAN BELIEVES THAT IT SHOULD MAKE AN EFFORT TO MEET AT LEAST A PART OF ITS CONTRACTUAL OBLIGATIONS FOR

DEBT SERVICE PAYMENTS. THOUGH THE PRESENT AND PROSPECTIVE  
BALANCE OF PAYMENTS POSITION DOES NOT EASILY PERMIT IT,  
PAKISTAN IS WILLING TO ENTER INTO DEBT RESCHEDULING ARRANGE-  
MENTS UNDER WHICH IT WOULD BE REQUIRED TO PAY ANNUALLY  
\$125 MILLION BY WAY OF DEBT SERVICING ON DEBTS INCURRED  
UP TO JUNE 1974, OTHER THAN SHORT-TERM DEBTS CONTRACTED  
RECENTLY.

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----- 108172

R 270800Z MAR 74

FM AMEMBASSY ISLAMABAD

TO SECSTATE WASHDC 3944

INFO AMCONSUL KARACHI

AMCONSUL LAHORE

LIMITED OFFICIAL USE SECTION 3 OF 3 ISLAMABAD 2930

KARACHI PASS ALSO TO USAID DIRECTOR

"10. THIS ARRANGEMENT CAN BE MAINTAINED UP TO 1979-80,  
WHICH WOULD BE THE TERMINAL YEAR OF THE FIFTH FIVE YEAR  
PLAN. DURING THIS PERIOD, IN ADDITION TO \$125 MILLION  
ANNUALLY ON OLD DEBTS. PAKISTAN WOULD BE MEETING ITS LIA-  
BILITIES FULLY ON FRESH DEBT CONTRACTED AFTER JUNE 1974.  
THIS LIABILITY WOULD BE GROWING DURING THE PERIOD. INCLUD-  
ING SERVICING OF SHORT-TERM DEBTS ALREADY INCURRED AND FRESH  
DEBTS CONTRACTED AFTER JUNE 30, 1974, DEBT SERVICE PAYMENTS  
WOULD  
GROW TO \$304 MILLION BY 1979-80 (ANNEXURE IV). PAKIS-

TAN HOPES TO BE IN A POSITION TO RESUME ITS FULL DEBT SERVICING OBLIGATIONS WITH EFFECT FROM FISCAL 1981.

"11. ON THE ABOVE BASIS THE RESCHEDULING OF DEBT SERVICING WOULD BE ON THE FOLLOWING PATTERN:--

DEBT SERVICE PAYMENTS DUE ON DEBTS INCURRED AMOUNT  
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UPTO JUNE 1974				IN EXCESS		
-----				OF \$125		
YEAR	CONSOR-	RESCHED-	BANK	NON-CON-	TOTAL	MILLION TO
TUM	ULED DEBT	GROUP	SORTIUM	DEBT	BE RESCHED-	
DEBT	DEBT	DEBT	SERVIC-	ULED		
			ING			
-----						
1975	167	85	59	26	337	212
1976	184	113	57	24	378	253
1977	199	107	60	22	388	263
1978	181	50	61	19	311	186
1979	173	6	60	15	254	129
1980	170	-	60	11	241	116

NOTE: FISCAL YEAR ENDS JUNE 30

IN THE ABOVE PROPOSAL A TOTAL RESCHEDULING OF THE ALREADY RESCHEDULED AMOUNT HAS BEEN PROPOSED WHICH WILL TAKE CARE OF THE 'HUMP' PROBLEM. IN ADDITION, THE CONSORTIUM MEMBERS WOULD BE REQUIRED TO RESCHEDULE ROUGHLY 75 PERCENT OF THE DEBT SERVICING AMOUNTS FALLING DUE DURING THE NEXT SIX YEARS ON DEBTS INCURRED UP TO JUNE 1974.

"12. THE PRESENT VALUE (IN FISCAL 1975) OF THE GRANT ELEMENT IMPLICIT IN THE RESCHEDULING ARRANGEMENT SUGGESTED ABOVE WORKS OUT TO ROUGHLY \$595 MILLION (ANNEXURE V). THIS IS STILL SUBSTANTIALLY BELOW THE PRESENT VALUE OF THE PAYMENTS BY PAKISAN IN RESPECT OF BANGLADESH DEBT. THUS, THE ARRANGEMENT PROPOSED HARDLY COMPENSATES PAKISTAN FOR CARRYING A LIABILITY FROM WHICH SHE HAS DERIVED NO BENEFIT.

"13. THE ABOVE PROPOSALS PROCEED ON THE ASSUMPTION THAT THE PAKISTAN GOVERNMENT WILL CONTINUE TO SERVICE LOANS BY THE WORLD BANK GROUP FOR COMPLETED PROJECTS VISIBLY LOCATED IN BANGLADESH, THE RESCHEDULED AMOUNTS

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PERTAINING TO BANGLADESH PROJECT AND COMMODITY LOANS, AS WELL AS PRIVATE AND JOINT PROJECT LOANS. IF, AS IS HOPED, PAKISTAN IS RELIEVED OF ANY PART OF THIS BURDEN, THE RE-SCHEDULING REQUIRED WILL BE AUTHOMATICALLY (SIC) REDUCED TO THAT EXTENT.

"14. THE ABOVE ARRANGEMENTS WOULD SERVE THE CAUSE OF EQUITY BY COMPENSATING PAKISTAN FOR CARRYING THE LIABILITY FOR, AND SERVICING, BANGLADESH DEBT. THEY WOULD ALSO ASSIST PAKISTAN IN MEETING ITS CURRENT BALANCE OF PAYMENT DIFFICULTIES. THIS DOES NOT, HOWEVER, PROVIDE A NET INFLOW OF RESOURCES INTO PAKISTAN OF THE MAGNITUDE REQUIRED TO SUSTAIN AN ADEQUATE DEVELOPMENT PROGRAMME. ON THE BASIS OF EXPERIENCE DURING THE PRESENT FISCAL YEAR, IT APPEARS THAT THE NET USE OF RESOURCES ABOVE THOSE GENERATED DURING THE CURRENT YEAR (I.E. NET EXTERNAL AID PLUS SHORT-TERM BORROWINGS PLUS DRAW-DOWN ON RESERVES) WOULD BE ABOUT \$400 MILLION. THIS WAS THE POSITION AT A TIME WHEN INVESTMENT WAS DEPRESSED. THE FUTURE REQUIREMENTS OF INVESTMENT DURING THE FIFTH PLAN WILL INCREASE THE NEED FOR ASSISTANCE FROM THE CONSORTIUM. PAKISTAN HOPES THAT IT WOULD BE FEASIBLE FOR THE CONSORTIUM TO INCREASE ITS GROSS AID INFLOW TO PAKISTAN SO THAT AN ADEQUATE NET INFLOW IS MAINTAINED FOR ACCELERATING ITS ECONOMIC DEVELOPMENT.

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## Message Attributes

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